United States
Environmental Protection
Agency

Office of Solid Waste &
Emergency Response
(5105)

EPA 500-F-01-338
August 2001
www.epa.gov/brownfields

EPA

# Brownfields Tax Incentive Guidelines

## Background

The U.S. Environmental Protection Agency (EPA) is committed to helping clean up and revitalize former industrial or commercial areas that were abandoned due to concerns about environmental contamination. EPA and its federal partners believe that, with the right incentives, these former engines of industrial growth can once again generate value for both the private and public sectors.

These areas are "brownfields," which EPA defines as "abandoned, idled, or under-used industrial and commercial facilities where expansion or redevelopment is complicated by real or perceived contamination." These properties may be large or small; urban or rural; former factories or warehouses. They have all been left idle due to concerns about cleanup costs and legal liabilities.

On the public sector side, economic development officials recognize that redevelopment can lead to a wide variety of public benefits, including reduced blight, new jobs, lower crime rates and higher tax revenues. Private sector companies have also seen the advantages of brownfields redevelopment. Many of these sites are located in areas with strong infrastructure, transportation, and urban markets.

To encourage this new interest in brownfields, EPA, the Department of the Treasury, and its other federal partners have created incentives for potential developers. One of these is the Brownfields Tax Incentive, signed into law as part of the Taxpayer Relief Act on August 5, 1997, and amended on December 21, 2000. Under the tax incentive, certain environmental cleanup costs at targeted sites may be fully deducted by eligible taxpayers in the year in which they are incurred, rather than having to be capitalized over time. The Treasury Department estimates that the $300 million incentive will leverage $3.4 billion in private investment and return some 8,000 brownfields to productive use.

This tax incentive is one of many federal initiatives to encourage business development and commercial economic revitalization. Programs exist that address a multitude of brownfields issues, including expanding access to capital, small business technical assistance, and workforce training and hiring incentives. Business owners should review the full range of initiatives available to help turn a brownfield into an attractive business location.

### An Introduction to Tax Incentives

The Brownfields Tax Incentive is not a tax credit, but reduces your tax burden indirectly by lowering your taxable income. The incentive does this by allowing you to claim eligible cleanup costs as a current *expense*, rather than *capitalizing* them as long-term assets. Companies prefer deductions because these substantially reduce their current income, allowing them to capture the tax savings now rather than later.

The Brownfields Tax Incentive encourages brownfields cleanup and redevelopment by allowing taxpayers to immediately reduce their taxable income by the cost of their eligible cleanup expenses. The incentive creates an immediate tax advantage from these expenses, helping to offset short-term cleanup costs. Additionally, companies operating at a loss in the first years of business may use the tax incentive to establish a "net operating loss" that may be applied in future taxable years.

### What's in These Guidelines

The next few pages of this guide will help you determine whether your property may be eligible to take advantage of the Brownfields Tax Incentive. This step-by-step guide covers:

- A fictional case study to show you the potential benefits of the incentive;
- A description of the types of taxpayers that may use the tax incentive;
- Guidelines on the types of eligible cleanup deductions you may take;
- A description of additional criteria for qualifying expenditures between August 5, 1997 and December 21, 2000; and
- Instructions on how to seek state verification of property and contamination eligibility.

## The Brownfields Tax Incentive:  A Fictional Case Study

The following fictional example is designed to show you how the Brownfields Tax Incentive could create value for your company. In the short run, eligible companies that use the incentive can gain a large cash infusion up front, which can be used to finance the cleanup or generate higher long-term returns because they have opted to reinvest some of their savings into other projects. Companies can also realize long-term benefits from the tax incentive.  By changing the timing of their tax payments, companies that use the incentive can reduce their total tax burden in real terms.

Both the scenarios and the assumptions used in the following fictional case have been simplified to provide readers with an easy analysis of the types of returns that could be achieved through use of the incentive.  Your project will have different levels of savings, depending on your circumstances.

**Acme Company**

The fictional Acme Company wants to locate its new factory on a plot of land in an inner- city neighborhood.  The Company hopes to employ local workers at the facility, generating both new jobs and income for the community.  While the plot is large enough for the new factory, it is contaminated with PCBs.  If one assumes that the Company will clean up its property at a particular cost, and that this cost may be "expensed" in the year in which it is incurred, then the Company will save dollars commensurate with its corporate tax rate.

### Scenario 1 –  Up-front Cash Infusion

Expensing cleanup costs in the year incurred will reduce the net income on which tax is paid.  In this way, a smaller portion of Acme's profit will go to pay taxes.  The savings incurred can then be used to defray the costs of the new factory and/or additional investment in company infrastructure and productivity.

From an economist's perspective, the value of Acme's redevelopment project is increased by the first year savings and earnings on this savings as measured by the time value of money.  Even if the savings could be realized over time, today's dollars are worth more than future dollars.

Additionally, a new company with large up-front costs or an ongoing concern contemplating a significant investment may use the tax incentive to create a net operating loss.  The net operating loss can be deducted by carrying the loss back 2 years when the business had profits or forward 20 years and deducted from future profits.

### Scenario 2 – Lower Real Tax Burden

Another way to view Acme Company's savings is by realizing that the actual value of the taxes paid is affected by when the payments are made.  Thus, by realizing tax savings in the first year, Acme's savings will be impacted over the usable life of the improved property by inflation.  Due to inflation, dollars saved in the present year are worth more than would be the dollars saved in the future years if the costs were amortized rather than expensed.  Thus, Acme's tax burden, in real terms, is lower if it uses the incentive.

## Step 1:  Determine whether you meet the taxpayer requirements.

- **The property must be "held by the taxpayer."** This definition includes outright ownership.  However, some types of long-term lease arrangements may qualify.  If there is a question, taxpayers should consult with their tax counsel to determine whether their circumstances qualify. A list of state Brownfields Tax Incentive contacts can be found at: **http://www.epa.gov/swerosps/bf/stxcntct.htm** .

- **The taxpayer must hold the property for business or income generation purposes**. This may include trade or business property, investment property, or property held as inventory. This does not include personal use property.

## Step 2: Find out which cleanup costs may be deducted.

In general, a property is eligible for the tax incentive if it is an area at or on which there has been:

- A release or threat of release of a hazardous substance; or
- Disposal of a hazardous substance.

However, the property must not be listed or proposed for listing on EPA's Superfund National Priorities List. The expenses associated with the cleanup must occur after August 4, 1997 and before January 1, 2003.

What constitutes a release or a threat of release?

A release under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) includes spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing of hazardous substances into the environment. The "environment" under CERCLA includes surface water, ground water, ambient air, and land, but does not include indoor areas. Therefore, for a release or a threat of release to exist, it must involve or threaten the outdoor environment.

What is a hazardous substance?

The Brownfields Tax Incentive defines "hazardous substance" as any substance that is defined under CERCLA. The list of CERCLA hazardous substances can be found at 40 CFR §302.4, Table 302.4. However, the Brownfields Tax Incentive excludes products that are part of the structure of a building and result in exposure within that building (e.g., interior lead-based paint or asbestos that results in indoor exposure) from its definition of a "hazardous substance," even if that substance is listed on Table 302.4. In addition, petroleum is not a "hazardous substance."

To determine whether a particular substance is a "hazardous substance," you should consult an environmental attorney. U.S. EPA Regional offices may be a source of information on defining a hazardous substance.

What expenses are eligible?

Generally, taxpayers may deduct those expenses that are paid or incurred in connection with the abatement or control of hazardous substances. For example, the costs of building an access road could be eligible if they were paid or incurred in connection with the abatement or control of hazardous substances, but not if they would just speed construction of a new building. If a taxpayer acquires otherwise depreciable property in connection with such an activity, the property's cost will not be immediately deductible, but may be expensed over the life of the property. Absent the Brownfields Tax Incentive, such depreciation would not be allowed.

Types of eligible expenses include:

- Site assessment and investigation;
- Site monitoring;
- Cleanup costs;

- Operations and maintenance costs;
- State voluntary cleanup program oversight fees; and
- Removal of demolition debris.

## Step 3: Ask your state for a statement that you are eligible for the tax incentive.

Before the IRS will accept the deduction, a designated state agency must provide you with a statement that there has been a release, threat of release, or disposal of a hazardous substance at or on the property. You can find your state's designated agency by visiting EPA's web site at:
**http://www.epa.gov/swerosps/bf/stxcntct.htm.** You may also call EPA's Brownfields Office at (202) 566-2777.

Each state agency will have a different application process and documentation requirements. Please note that the designated state agencies do not determine whether a given expenditure is eligible. Taxpayers should work with their tax counsel on the matter of eligible expenses. Taxpayers should also be aware that states are not precluded from using information provided by a taxpayer to take action at a property under state cleanup or enforcement authorities.

## Step 4: Additional criteria for qualifying expenditures between August 5, 1997 and December 21, 2000.

As mentioned in the "Background" section of these guidelines, the Brownfield Tax Incentive's geographic requirements for property eligibility have been eliminated for expenditures on or after December 21, 2000. While amended tax returns may be filed to deduct expenditures from prior tax years (provided that the costs were incurred after August 5, 1997, the effective date of the initial tax incentive law), costs incurred prior to December 21, 2000 can only be deducted in the same year if the property meets any of the following geographic criteria:

- Census tracts with poverty rates of 20 percent or more;
- Census tracts with populations of less than 2,000 where more than 75 percent of the tract is zoned for commercial or industrial use, and the tracts are adjacent to one or more census tract(s) with poverty rates of 20 percent or more;
- Federally designated Empowerment Zones (EZ) or Enterprise Communities (EC); and
- EPA-designated Brownfields Pilot sites announced before February 1, 1997.

If the costs were incurred between the applicable dates, the taxpayer should work with their state environmental agency and their tax counsel to ensure that the property lies within an eligible area. The taxpayer will have to obtain a statement from the state environmental agency that the property is within an eligible area (and that it is a property at or on which there has been a release, threat of release, or disposal of a hazardous substance at or on the property– see Step 3). Sites on EPA's Superfund National Priorities List (NPL) are not eligible for the Incentive.

**Other Resources**

These guidelines were prepared in partnership with Department of Treasury, Department of Commerce's Economic Development Administration, Department of Housing and Urban Development, and the Small Business Administration. Taxpayers should also consider the following resources for information on the Brownfields Tax Incentive.

- **Internal Revenue Service publications**. Further information is available in IRS publication 954, "Tax Incentives for Empowerment Zones and Other Distressed Communities" at **http://www.irs.gov/pub/irs-pdf/p954.pdf** . To confirm whether property or expenses are eligible for deduction under the tax incentive, taxpayers should consult with tax counsel. It may also be useful to consult with an environmental attorney. In addition, the identified state contacts listed on the next page may provide needed technical assistance on using the tax incentive.
- **U.S. Environmental Protection Agency**. Additional fact sheets on the Brownfields Tax Incentive are available at **www.epa.gov/brownfields/** or by calling (202) 566-2777.
- **HUD's Community Connections Service**. You can receive technical assistance and printed materials on the Brownfields Tax Incentive by calling (800) 998-9999.
- **U.S. EPA's Enviromapper**. This web-based database enables a user to map various types of environmental information, including air releases, drinking water, toxic releases, hazardous wastes, water discharge permits, and Superfund sites. Enviromapper can be accessed at **http://www.epa.gov/enviro/html/em/index.html**.

## Contact List for States and Territories

*List available on the Internet at **www.epa.gov/brownfields/stxcntct.htm***